State of Washington

Department of Labor and Industries

Industrial Insurance Fund

SAP Financial Information

Fiscal Year Ended June 30, 2005

Prepared by the Financial Services Program

Department of Labor and Industries
Industrial Insurance Fund
SAP Financial Information
Fiscal Year Ended June 30, 2005

Table of Contents

Management's Discussion and Analysis of Results of Operations and Financial Position

Introduction

The Department of Labor and Industries (the Department) administers the Industrial Insurance Fund (the Fund) and the Workers' Compensation Insurance program in the state of Washington. The Fund pays Workers' Compensation benefits for wages lost during disability, permanent partial and total disability, vocational rehabilitation and medical costs incurred in conjunction with the injury. For employers and employees covered by the Fund, and not self-insured, premiums paid and earnings of the Fund's investment portfolio provide for the benefits paid.

Cash Flow

Premiums collected during fiscal year 2005 of $1.367 billion are an increase of 14.8 percent over fiscal year 2004. This increase is due to higher premium rates and growing exposures with the improving economy and more workers employed and thus more hours reported.

Benefits paid during fiscal year 2005 totaled $1.19 billion with a relatively flat growth rate of 1.9 percent from fiscal year 2004. The ratio of expenses paid to benefits paid increased slightly, as expenses increased 19.7 percent over fiscal year 2004.

Investment cash flow from equity securities dividends of $35 million and fixed income securities interest earnings of $454.5 million increased slightly from fiscal year 2004 as investment yields continue to decrease while the assets increase, with net cash decreasing because of increases in investment purchases.

Financial Condition

Total Fund equity holdings increased $151 million and Fixed Income holdings increased $428 million over 2004 year end values. These increases, coupled with a net increase in premiums earned after adjusting for a 50 percent growth in Retrospective Rating refunds, greatly contributed to the contingency reserve growth of $405 million during fiscal year 2005. This growth is not uniform across the accounts within the Fund as Accident is below its targeted reserve and Medical Aid is far exceeding its targeted reserve.

Contingency Reserve

Fund	Target % of Total Liability	Current	Target Upper Limit	Above (Below)
Accident	10%	$301 M	$356 M	$(54) M
Medical Aid	15%	$876 M	$433 M	$442 M
Pension	1%	$(21) M	$23 M	$(44) M

Reserves

Total benefit reserves increased by $199 million in the fiscal year. The Accident Fund reserve increased $68 million, the Medical Aid Fund decreased $59 million, and the Pension Reserve Fund increased $190 million. Non-pension benefits in the Accident and Medical Aid Funds are discounted at 2.5 percent, while the pension benefits in the Accident and Pension Reserve Fund are discounted at 6.5 percent. These benefit reserves increased while the non-pension discount rate decreased from 4 percent in the Accident and Medical Aid Funds to the current 2.5 percent.

Benefit and Claims Administration Expense Reserves as of June 30, 2005
(in thousands)

Fund	**Undiscounted** (except pensions)	Discounted	Carrying Value	Difference	Percent Difference
Accident					
Benefit	$ 3,594,675	$ 3,240,413	$ 3,240,413	$ 354,262	10%
Claim Admin	172,158	153,098	153,098	19,060	11%
Medical Aid					
Benefit	4,073,953	2,642,908	2,642,908	1,431,045	35%
Claim Admin	249,474	218,634	218,634	30,840	12%
Pension					
Benefit	2,283,885	2,283,885	2,283,885	NA	NA
Totals	$ 10,374,145	$ 8,538,938	$ 8,538,938	$ 1,835,207	18%

Liquidity and Capital Resources

The Fund's operation requires liquidity sufficient to meet both short-term and long-term requirements. Short-term liquidity requirements come from three basic elements. First, Workers' Compensation claims are subject to some variation, usually inflationary. Second, benefit payments and investments are sensitive to variations in premium adequacy. Finally, retrospective returns require an increased degree of liquidity.

The Fund has generally met its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio and through utilization of positive cash flow. The Fund has the financial capacity to hold its fixed income portfolio to maturity and to match projected cash inflows from premiums and investment income from this portfolio with projected cash outflows for payment of benefits.

All equity holdings are in the form of index funds with securities divided between 84.2 percent held in US Equity Market Fund B and 15.8 percent held in MSCI EAFE Index SL CTF for International Equities as of fiscal year ended June 30, 2005. This combination yielded $28.6 million in dividends and $7.2 million in realized gains on trades for fiscal year 2005.

Fixed income securities are reported at amortized cost, which adjusts for any premiums or discounts with the respective interest payment or when traded. Unrealized gains or losses on these securities are not recognized until matured or traded. Generally these securities are purchased to provide income and are held until maturity. Carrying the value at amortized cost avoids wide swings in value because of changing interest rates. These securities yielded $471 million in interest income net of amortization and realized gains on trades of $143 million.

Costs of this investing activity included $26.3 million in management fees plus $1 million in administrative costs incurred by the State Investment Board in managing and reporting on the Fund's investments.

Statutory Combined Balance Sheet
Accident, Medical Aid, and Pension Reserve Funds
As of June 30,

	(amount in thousands) 2005	2004
Assets		
Cash and Investments:		
Fixed Income, at Amortized Cost	7,562,707	7,134,852
Equities, at Market Value	1,807,368	1,656,180
Fixed Income Trades Receivables	30,121	33,241
Interest Receivable	100,709	87,926
Cash	629	4,111
Total Cash and Investments	9,501,534	8,916,310
Other Assets:		
Premiums Receivable, Standard	398,054	344,205
Land, Buildings and Equipment, Net	17,228	11,509
Self-Insured Receivable, Net	5,628	17,176
Miscellaneous	1,875	2,599
Total Other Assets	422,785	375,489
Total Assets	9,924,319	9,291,799
Liabilities and Contingency Reserve		
Liabilities		
Benefits:		
Accident Fund	3,240,413	3,171,960
Medical Aid Fund	2,642,908	2,701,872
Pension Fund	2,283,885	2,094,403
Total Estimated Future Benefits	8,167,206	7,968,235
Other Liabilities:		
Claims Administration	371,732	377,903
Retrospective Rating Adjustments, Net	145,761	111,037
Other Accrued Liabilities	44,362	43,299
Deferred Revenue	2,392	3,135
Total Other Liabilities	564,247	535,375
Total Liabilities	8,731,453	8,503,610
Contingency Reserve	1,192,866	788,189
Total Liabilities and Contingency Reserve	9,924,319	9,291,799

The source of this financial information is Washington State's
Accounting and Financial Reporting System adjusted for insurance reporting

Statutory Statements of Operations
Accident, Medical Aid, and Pension Reserve Funds
For Fiscal Years Ended June 30,
(amounts in thousands)

	(amount in thousands) 2005	2004
Revenues		
Premiums Earned	$ 1,421,200	$ 1,229,483
Less Retrospective Rating Adjustments	(152,987)	(102,810)
Net Premiums Earned	$ 1,268,213	$ 1,126,673
Net Investment Income	472,762	432,389
Investment Gains	151,171	435,652
Self-Insured Pension Reimbursements	70,541	67,647
Other Income	15,540	17,650
Total Revenues Earned	$ 1,978,227	$ 2,080,011
Expenses		
Benefits Incurred	$ 1,386,587	$ 1,584,660
Claims Administrative Incurred	112,202	31,697
Premium Administration Incurred	25,615	27,359
General Insurance Incurred	19,133	13,100
Other Administrative Incurred	68,504	50,414
Total Expenses Incurred	$ 1,612,041	$ 1,707,230
Net Income	$ 366,186	$ 372,781
Change in Non-Admitted Assets	38,491	(41,190)
Change in Contingency Reserve	$ 404,677	$ 331,591
Contingency Reserve, Beginning of Period	788,189	456,598
Contingency Reserve, End of Period	$ 1,192,866	$ 788,189

Summary Statutory Statements of Cash Flows
Accident, Medical Aid, and Pension Reserve Funds
Fiscal Years Ended June 30,

	(amount in thousands) 2005	2004
Operating Cash Flow		
Standard Premiums	$1,367,351	$1,191,080
Retrospective Rating Adjustments	(118,263)	(101,996)
Net Premiums Collected	$1,249,088	$1,089,084
Self Insured Pension Reimbursements	73,176	68,489
Other Income (Expense)	4,345	(368)
Cash Flow In	$1,326,609	$1,157,205
Benefits Paid	$1,187,616	$1,166,104
Claims Administrative Expense Paid	118,373	89,157
Premium Administrative Expense Paid	21,710	25,599
General Insurance Expense Paid	13,176	12,449
Other Administrative Expense Paid	70,003	60,917
Self Insured Admin Expense Reimbursements	(13,655)	(13,011)
Cash Flow Out	$1,397,223	$1,341,215
Net Operating Cash Flow	($70,614)	($184,010)
Investment Cash Flow		
Net Investment Income - Bonds	$454,524	$447,166
Net Investment Income - Equities	35,251	25,825
Net Investment Sales and (Purchases)	(421,706)	(257,141)
Investment Expenses & Other Income	(937)	(1,307)
Net Cash Flow	($3,482)	$30,533
Beginning Cash	4,111	(26,422)
Ending Cash	$629	$4,111

Notes to Financial Information

Note A – Summary of Significant Reporting Policies

The state of Washington prepares a Comprehensive Annual Financial Report (CAFR), audited annually by the State Auditor's Office, which includes all funds and subsidiary accounts of the State. The CAFR is prepared in accordance with generally accepted accounting principles (GAAP) as promulgated by the Governmental Accounting Standards Board and formatted according to the guidelines issued by the Government Finance Officers Association. The financial activities of the Workers' Compensation Fund are included in the CAFR as a major fund.

The accompanying financial information is based on statements of statutory accounting principles (SSAP) as promulgated by the National Association of Insurance Commissioners, as would be required of any property and casualty insurance enterprise in the United States when reporting its financial condition to state insurance regulators. This accounting basis is used to present insurance solvency and the adequacy of premium rates.

The Supplemental Pension and Second Injury Funds (see Note C) are not included in this financial information because its primary purpose is to present the financial condition and results of operations of those funds required to maintain actuarial solvency as a basis for premium rates. In the State's CAFR schedules, the insurance funds presented in this report are called the Basic Plan.

Additionally, certain classes of assets and liabilities that are shown on the CAFR are excluded in these SSAP based reports. The inclusion of these classes of assets and liabilities are deemed not to add to the evaluation of the actuarial solvency of the funds. Assets and liabilities from securities lending agreements, securities held in a custodial arrangement for the US Department of Energy, the bond obligations issued to finance the state building housing the Department of Labor and Industries, and the unrealized gain or loss on fixed income securities are the principal classes of assets and liabilities excluded.

In addition, under SSAP, certain assets (principally unrealized gains and losses on investments and otherwise capitalized furniture and equipment) are charged against the contingency reserve. Under GAAP, such assets would be reported on the Statement of Net Assets as assets less any applicable accumulated depreciation.

Note B – Description of the Industrial Insurance Fund

Washington State, through Title 51 Revised Code of Washington (RCW), requires employers to secure payment of benefits for job-related injuries and diseases either by paying insurance premiums to the Workers' Compensation Fund or by self-insuring.

Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

The statute provides five benefit funds to make compensation payments to injured workers or to medical providers for rehabilitation services to injured workers. The Accident, Medical Aid, and Pension Reserve Funds are required to be self-sustaining by insurance premiums. These financial information statements report on the financial condition and results of operations of these three funds known collectively as the State Fund.

The Accident Fund pays compensation directly to injured workers for lost wages during temporary disability, for permanent partial disability awards, and awards pensions to survivors of fatally injured workers and to workers adjudged to be permanently and totally disabled. Such claim liabilities are discounted for fiscal year 2005 to the present value assuming a 2.5 percent annual interest rate.

Revenues for this fund are provided by employer paid premiums, calculated on the basis of hours worked. However, employers may elect to have their premiums retrospectively rated with an adjustment for actual losses incurred. This may result in either a rebate of premiums paid or an assessment of additional premiums due. All retrospective premium adjustments are financed entirely through the Accident Fund. The adjustment calculation considers both the Accident and Medical Aid Fund experience and premiums together; however, no retrospective premium adjustments are made through the Medical Aid Fund.

The Medical Aid Fund pays for the cost of medical and vocational rehabilitation services to injured workers. Employers are allowed to withhold half of the medical aid premium from their employees' wages. Medical reserves are discounted to the present value assuming a 2.5 percent annual interest rate. Revenues for this fund are usually provided by equal contributions from employers and employees.

The Pension Reserve Fund pays benefits to all permanently disabled pensioners including disabled employees of self-insured employers. These reserves are discounted to the present value assuming a 6.5 percent annual interest rate. Revenues to fund the pension payments are provided with transfers from the Accident Fund and reimbursement payments from self-insurers invested in securities selected to cover payments for the expected life of the injured worker.

These funds are maintained on an actuarially solvent basis, except that a cash-flow basis is authorized for the components of the Pension Reserve Fund when self-insured employers guarantee related benefits with a surety bond.

Actuaries employed by the Department compute benefit loss and claim administration expense liabilities. Actuaries from Milliman USA, independently review these liabilities after the fiscal year end. These liabilities are estimated future claims and claims administrative expense payments for injuries occurring on or before the Statutory Summary of Financial Position date on a discounted basis.

Future premium income is not offset against claims liabilities, as the claims liabilities arise from coverage periods for which premiums have, in general, already been fully earned.

The obligation to pay claims expenses and claims administration liabilities is not contingent upon any future premiums for future coverage periods.

Note C – Other Related Funds

The Second Injury Fund is used to pay pension costs on claims where permanent total disability is at least partially caused by a prior injury. It is funded by amounts received from the Accident and Medical Aid Funds for state fund claims and by self-insured assessments for self-insured claims. An allowance for future second injury benefit payments is contained within the Accident and Medical Aid Fund claim reserves for State Fund claims. Therefore, this fund does not carry any reserves. This fund's operations are not directly reported in these financial information statements, but second injury claims, which it services, are reported appropriately in the State Fund and its three operating funds, Accident, Medicaid, and Pension Reserve Funds.

The Supplemental Pension Fund provides for supplemental cost-of-living adjustments (COLA) to injured employees receiving disability payments. However, the enabling legislation requires this fund to operate on a current payment basis and is subject to legislative cancellation. No assets are allowed to accumulate for the future servicing of current claims.

Cost-of-living pension payment increases are based on the increase in the state average wage during the preceding calendar year and are granted in July of the ensuing year. Revenues for COLA payments arise from assessments to self-insured and State Fund employers; half of the assessment may be deducted from employees' wages. Income, expense, assets, or future claim liabilities related to Supplemental Pension or Second Injury Funds are not included in these financial information statements.

Note D – Investments

All equity holdings are in the form of index funds with securities divided with 84.2 percent held in US Equity Market Fund B and 15.8 percent held in MSCI EAFE Index SL CTF for International equities as of the fiscal year ended June 30, 2005. Equities are carried and reported at fair or market value.

Fixed income securities are reported at amortized cost which adjusts for any premiums or discounts with the respective interest payment or when traded. Unrealized gains or losses on these securities are not recognized until matured or traded. Generally these securities are purchased to provide income and are held until maturity. Carrying the value at amortized cost avoids wide swings in value because of changing interest rates.

On June 30, 2005, fixed income securities are classified and valued as follows:

(in millions)

Asset Class	**Reported Value (Amortized Cost)**		**Fair Value**		**Unrealized Gain (Loss)**
Corporate	$4,572	60.5%	$4,973	61.0%	$401
Mortgages and Mortgage Backed	1,684	22.3%	1,627	19.9%	(56.2)
US Treasury Securities	1,000	13.2%	1,249	15.3%	248.9
Asset Backed Securities	11	0.1%	12	0.1%	.4
Variable Rate Notes	157	2.1%	158	2.0%	.8
Money Market	139	1.8%	139	1.8%	-
Totals	$7,563	100.0%	$8,158	100.0%	$594.9

Investment Policy

Under the Revised Code of Washington (RCW) 43.33A.030, trustee of the Fund is vested in the voting of the Washington State Investment Board (SIB). The legislature has established a standard of care for investment of the Fund in RCW 43.33A.140. Additionally, RCW 43.33.110 states the strategic objective for managing the Fund's portfolio is to limit fluctuations in the industrial insurance premiums, and subject to objective, achieve a maximum return at a prudent level of risk. Based on these requirements, the order of objectives is:

1. Maintain the solvency of the Fund.
2. Maintain premium rate stability.
3. Ensure sufficient assets are available to fund the expected liability payments.
4. Subject to the above, achieve a maximum return at a prudent level of risk.

The Fund Asset Allocation reflects this policy with the current targets and ranges:

Fund	Fixed Income Target	Equity Target	Equity Range
Accident	90%	10%	8% - 12%
Medical Aid	70%	30%	24% - 36%
Pension Reserve	90%	10%	8% - 12%

Note E – Premiums Receivable, Net

All employers in Washington subject to Title 51 of the Revised Code of Washington are required to provide Workers' Compensation insurance by paying premiums to the Industrial Insurance Fund or by electing and qualifying for self-insure. Premiums are normally based on each employer's reported payroll hours and insurance rates based on the employer's risk classification(s) and past employee injury experience.

In addition to its regular premium plans, the Fund offers a retrospective premium rating plan under which premiums are adjusted annually for up to four years following the plan year based on the employers' loss experience. Adjustments to the original premiums are paid or collected from the associations and employers approximately ten months after the end of each plan year.

Employers' Workers' Compensation insurance premiums are due 30 days following each calendar quarter in which payroll hours are reported. A premium receivable is established for each employer not fully paying or not reporting its payroll hours as of the due date set each quarter. Additionally, an allowance for uncollectible premiums is established based on an evaluation of outstanding premium receivables. Further, for reporting in accordance with SSAP, all premium receivables exceeding 30 days in age are adjusted and expensed to bad debts expense in the current period. However, collection efforts are continued until the premiums are collected or all legal means are exhausted.

Note F – Reinsurance

The Department maintains an agreement with a reinsurance broker to purchase reinsurance at reasonable rates. Current rates exceed what are considered reasonable rates. Therefore, the Department does not carry any catastrophic reinsurance coverage for its Workers' Compensation Program. However, the Department remains in contact with the broker and will purchase reinsurance coverage when it becomes available at reasonable rates.

Note G – Estimated Future Benefits

Reserves for unpaid benefits and claims administration expenses in the Accident and Medical Aid Funds are provided based primarily on ratios of paid to date losses for older accident periods. For more recent accident periods, selections of several common actuarial techniques are used. These estimates are continually under review, and as changes to these liabilities become necessary, such adjustments are reflected in current income.

For insurance reporting purposes under SSAP requirements, these estimates are calculated and presented net of all recoveries. Reporting under GAAP requirements, these estimates are presented at the discounted present value without an adjustment for recoveries. Recoveries include overpayments and successful subrogation against third parties. Recoveries may be in the form of cash or deduction against continuing benefits.

The liability for benefits in the Pension Reserve Fund is determined from individual claims transferred to this fund using actuarial pension annuity tables. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided.

Claims Liability Development by Program
(in thousands)

Program/ Category	Undiscounted Liabilities	Discount Rate	SSAP Liabilities	Overpayment Adjustments	GAAP Liabilities
Accident	$3,594,675	2.5%	$3,240,413	$14,687	$3,255,100
Medical Aid	4,073,953	2.5%	2,642,908	968	2,643,876
Pensions	8,331,696	6.5%	2,283,885	1,316	2,285,201
Sub-Total Benefit Reserve	$16,000,324		$8,167,206	$16,971	$8,184,177
Claim Admin Expense (CAE)	$421,632	2.5%	$371,732		$371,732
Total Benefits & CAE Reserves	$16,421,956		$8,538,938	$16,971	$8,555,909

Note H – Land, Buildings and Equipment, Net

Purchased or constructed assets with a value of $5,000 or greater are capitalized and depreciated over the useful lives in accordance with the State of Washington's State Administrative and Accounting Manual. However, for insurance reporting, not all capitalized assets are admitted for reporting purposes, but are adjusted from the respective fund's contingency reserve with current purchases immediately expensed. For fiscal year 2005, the Accident and Medical Aid operating funds admitted only the investment in land, buildings, other improvements, and operating software, net of accumulated depreciation.

Additionally, per SSAP No. 40 (4) & (6), buildings are reported net of encumbrances, which for the Industrial Insurance Fund are the general obligation bonds issued for the construction of the building housing most of the Fund's employees.

Reconciliation of Capital Assets to Report
(in thousands)

Capital Asset	Accident Fund			
	Carrying Value	**Non Admitted**	**Encumbrance**	**Net Admitted**
Land	$ 1,602	$ -	$ -	$ 1,602
Art & Library Reserve	18	(18)	-	-
Buildings	31,220			
Less Depreciation	(8,686)	-	(19,935)	2,599
Improvements	511			
Less Depreciation	(128)	-	-	384
Equipment & Software	25,212			
Less Depreciation	(5,606)	(15,482)	-	4,123
Library Resources	416			
Less Depreciation	(279)	(137)	-	-
Sub-Total	$ 44,280	$ 15,637)	$ (19,935)	$ 8,709

Capital Asset	**Medical Aid Fund**			
	Carrying Value	**Non Admitted**	**Encumbrance**	**Net Admitted**
Land	$ 1,602	-	-	$ 1,602
Art & Library Reserve	18	(18)	-	-
Buildings	31,221	-		
Less Depreciation	(8,686)	-	(19,935)	2,600
Improvements	509	-		
Less Depreciation	(127)	-	-	382
Equipment & Software	24,884			
Less Depreciation	(6,422)	(14,527)	-	3,935
Library Resources	416			
Less Depreciation	(279)	(137)	-	-
Sub-Total	$ 43,136	$ (14,682)	$ (19,935)	$ 8,519
Total Capital Assets	**Industrial Insurance Fund**			$ 17,228

Note I – Commitments and Contingencies

Effective July 1, 1992, the Washington State Legislature required the Fund under RCW 48.22.070 to participate in an assigned risk pool providing Workers' Compensation coverage under the United States Longshore and Harbor Workers' Act. The Fund is obligated to participate 50 percent in the underwriting losses or surpluses of the assigned risk pool. This participation is scheduled to continue indefinitely due to amending legislation passed in 1997. However, the Fund has not made any payments to this risk pool since enactment of this indefinite commitment.

STATEMENT OF ACTUARIAL OPINION - DEPARTMENT OF LABOR & INDUSTRIES

AS OF JUNE 30, 2005

Identification

I, Guy A. Avagliano, am associated with Milliman, Inc. I am a member of the American Academy of Actuaries and meet its qualification standards for statements of actuarial opinion. I am also a Fellow of the Casualty Actuarial Society. The loss and loss adjustment expense reserves are the responsibility of the Department's management; my responsibility is to express an opinion of those reserves based on my review.

Scope

I have performed separate actuarial reviews of the reserves for loss and loss adjustment expense as of June 30, 2005 in the Accident Fund ($3,393,511,000), Medical Aid Fund ($2,861,542,000), and Pension Reserve Fund ($2,283,885,000) for the Department. These reserves are contained in the Industrial Insurance Balance Sheet as of June 30, 2005.

My examination of the loss and loss adjustment expense reserves was based upon the review of the data and related information, methodology, assumptions, and calculations utilized by the Department. In this regard, I relied on the Department as to the accuracy and completeness of the data. In performing this evaluation I evaluated the data used directly in my analysis for reasonableness and consistency. My evaluation did not reveal any data points materially affecting my analysis that fell outside of the range of reasonable possibilities. In performing this evaluation, I have assumed that the Department (a) used its best efforts to supply accurate and complete data and (b) did not knowingly provide inaccurate data. In other respects, my examination included the use of such actuarial assumptions and methods and such tests of calculations as I considered necessary.

My review was limited to the items listed above and did not include an analysis of any income statement items or other balance sheet items. My opinion on the reserves is based upon the assumption that all reserves are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet cash flow requirements.

I evaluated the loss and loss adjustment expense reserves on a discounted basis with regard to the time value of money. The average interest rate used to discount was 3.5%, which I consider reasonable. I evaluated the loss and loss adjustment expense reserves, net in regards to salvage and subrogation, and gross of reinsurance.

Opinion

In my opinion, these reserves are consistent with reserves computed in accordance with Standards of Practice issued by the Actuarial Standards Board (including the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves) and make a reasonable provision for all the unpaid loss and loss adjustment expense obligations of the Department under the terms of its policies and agreements.

Comments

The Department writes a coverage whose risk factors expose the Department's reserves to significant variability. I have identified the major risk factors that could have a material impact as rising medical costs and any future court decisions that could have a retrospective impact on liabilities. The potential impact of these risk factors is described in more detail in the following paragraph and in the report supporting this opinion. The absence of other risk factors from this listing does not imply that additional risk factors will not be identified in the future as having been a significant influence on the Department's reserves.

The risk factor of rising medical costs is evident by the escalation of recent trend levels and continuation at this level would have a material impact on the reserves. Future court decisions are also a risk factor that could have a material impact, with a recent example being the impact the *Cockle* decision had on reserves.

I believe the risk factors above, coupled with the variability that is inherent in any reserve estimate, could result in material adverse deviation from the carried reserve. In making this determination, I have considered a material adverse deviation to be one in which the actual reserves exceed the amounts above by an amount greater than 10% of the reserves. Other measures of materiality might be used for reserves that are being evaluated in a different context.

In evaluating whether the reserves make a reasonable provision for unpaid losses and loss expenses, it is necessary to project future loss and loss adjustment expense payments. These estimates incorporate actuarial assumptions as to future long-term contingencies based upon the available data. It is certain that actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further the projections make no provision for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Department's historical database or which are not yet quantifiable.

The statement of opinion is solely for the use of, and only to be relied upon by, the Department and the State of Washington.

Signed by Guy A. Avagliano
Fellow, Casualty Actuarial Society
Member, American Academy of Actuaries
November 21, 2005

Signed original on file